

## Franchise Tax Board

## ANALYSIS OF ORIGINAL BILL

Author: Scott & Corbett Analyst: Roger Lackey Bill Number: AB 1756  
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 01-14-00  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Seismic Retrofitting Credit

SUMMARY

This bill would provide a credit equal to 55% of the amount paid or incurred for seismic retrofit construction on single-family or multiple-family residential structures constructed before 1979.

EFFECTIVE DATE

This bill would be effective January 1, 2000, and operative for taxable and income years beginning on or after January 1, 2001, and before January 1, 2007.

LEGISLATIVE HISTORY

SB 875 (95/96, failed passage) would have allowed a credit for an amount equal to 10% of the costs for rehabilitating a residential historic building and 20% for a commercial historic building; SB 1628 (93/94, failed passage) would have allowed a credit for an amount equal to 10% of the costs for rehabilitating historical buildings.

SPECIFIC FINDINGS

**Existing state and federal laws** generally allow a depreciation deduction to the owner for the obsolescence or wear and tear of property used in a business or investment property. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. Depreciable property includes equipment, machinery, vehicles and buildings, but excludes land. Significant improvements to property increase the basis of the property and are depreciated over its remaining useful life. Ordinary and necessary expenses to repair property used in a trade or business or held for the production of income are deductible.

**Existing state and federal laws** do not allow homeowners to deduct expenses to repair a personal residence or to depreciate a personal residence. However, significant improvements may increase the basis of a residence. When the residence is sold, the basis of the residence is adjusted to reflect the property's improvements and subsequently the gain or loss recognized upon the sale of the residence is adjusted for the costs incurred by the taxpayer to make those improvements.

## Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

## Department Director

## Date

Gerald H. Goldberg

2/17/00

**Existing state and federal laws** provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child and dependent care credits) or to influence behavior, including business practices and decisions (e.g., research credits).

**Under Personal Income Tax Law (PITL) and Bank & Corporation Tax Law (B&CTL)**, this bill would provide a credit equal to 55% of the amount paid or incurred during a taxable or income year for any seismic retrofit construction on a single-family or multiple-family residential structure constructed prior to 1979 and located in this state.

**This bill** would provide that the credit allowed not exceed \$5,000 for each single-family residential structure and \$2,500 for each unit in a multiple-family residential structure.

**This bill** would define the term "seismic retrofit construction" as changes or additions to a structure or other attached improvements of a single-family or multiple-family residential structure to mitigate seismic damage, including, but not limited to:

- Anchoring the structure to the foundation.
- Bracing cripple walls.
- Bracing hot water heaters.
- Installing automatic gas shut-off valves.
- Repairing or reinforcing the foundation to improve the integrity of the foundation against seismic damage.
- Anchoring fuel storage.
- Installing certain earthquake-resistant bracing systems for mobile homes.

"Seismic retrofit construction" would not include construction activities performed solely to bring a single-family or multiple-family residential structure into compliance with standard local building codes.

**This bill** also would define the terms "single-family residential structure," "multiple-family residential structure," and "dwelling unit."

In addition, **this bill** would provide that to qualify for the credit, the seismic retrofit construction of a light wood-frame dwelling with four or fewer dwelling units must comply with Appendix Chapter 6 of the 1997 Edition of the Uniform Code for Building Conservation. In the case of an apartment, condominium, or congregate residence with more than four dwelling units, the seismic retrofit construction must be designed by a licensed architect or registered civil engineer.

**This bill** would provide that to compute the credit the seismic retrofit construction costs would be reduced by any grant provided by a public entity for the retrofit construction.

Any unused credit could be carried over for eight years.

Since **this bill** does not specify otherwise, if two or more taxpayers (except a husband and wife) share in the costs of the seismic retrofit construction, each taxpayer would be eligible to receive the credit in proportion to the taxpayer's costs paid or incurred. In the case of a pass-through entity (partnership or S corporation), the credit would be allocated according to the general rules for such pass-through entity.

This credit would not reduce regular tax below the tentative minimum tax for purposes of the alternative minimum tax (AMT) calculation.

#### Policy Considerations

There may be conflicting tax policies when a credit is provided for an expense item for which preferential treatment is already allowed in the form of a deduction. This proposed credit would have the effect of providing a double benefit for taxpayers that are allowed to deduct the expense of seismic retrofit construction or include the seismic retrofit construction expense in their basis for depreciation. However, eliminating the double benefit by denying the deduction or making an adjustment to reduce basis would create a state and federal difference, which is contrary to the state's general conformity policy.

#### Implementation Considerations

It is unclear how the Franchise Tax Board would verify whether a taxpayer's seismic retrofit construction meets the requirements of this bill and is therefore eligible for the credit. The author may consider requiring the proper local authority to certify that the seismic retrofit construction met the requirements of this bill and requiring the taxpayer to obtain, retain and provide to the Franchise Tax Board, upon request, evidence of that certification.

Except for the implementation concern above, implementing this bill would not significantly impact the department's programs and operations.

#### Technical Considerations

The credit language refers to a \$2,500 limitation per "unit" in a multiple-family residential structure, while the definitional sections define a "dwelling unit." It is unclear whether the word "dwelling" was intended to precede "unit" in the credit limitation language, or whether the author intends the credit limitation language to apply to non-dwelling units in multiple-family residential structures such as community clubhouses or other common areas.

### FISCAL IMPACT

#### Departmental Costs

Once the implementation concerns are resolved, this bill would not significantly impact departmental costs.

### Tax Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follows:

Estimated Revenue Impact AB1756 (In millions)			
Taxable or Income Years Beginning After 12/31/2000			
Assumed Enactment After 6/30/2000			
2000-1	2001-2	2002-3	2003-4
Minor Loss*	-\$10	-\$15	-\$30

\*Minor = Less than \$500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

### Revenue Discussion

The impact of this bill would depend upon the number of individuals incurring qualifying retrofit expenses and the average credit applied against tax liabilities.

This estimate is based on actual departmental data regarding the previous solar energy credit, adjusted for differences between the two (i.e., credit limitations, universe of potential taxpayers, difference in qualifying cost, etc.). For purposes of this analysis the solar energy credit was used primarily to determine taxpayer behavior (i.e. learning curve) and the credit usage rate. In addition, the following data and assumptions were used:

1. It was assumed that the majority of taxpayers claiming the credit would be located within high earthquake probability counties. According to information from the 1990 U.S. census data, U.S. Geological Survey and various geological studies, approximately 80% of California residential housing is located within high earthquake probability counties. In these counties, approximately 32% of the housing was built prior to 1979 (credit applies to seismic retrofit construction on pre-1979 structures).
2. Costs for retrofitting can vary from as low as \$1,700, with many projects between \$2,000 and \$4,000, and a few with major complications as high as \$10,000 to \$12,000.
3. Assumptions were made that approximately one-third of pre-1979 residential housing located in high earthquake probability counties has had some seismic retrofit construction. This assumption is based on construction increases after major earthquakes and assumes that repairs of many damaged houses would have included some seismic retrofit.

In summary, in the first full year it is estimated that approximately 10,000 residential units (single family and multiple family) would incur qualified costs for an average applied credit of approximately \$1,100.

### BOARD POSITION

Pending.